

**§ 1.737-5 Effective date.**

Sections 1.737-1, 1.737-2, 1.737-3, and 1.737-4 apply to distributions by a partnership to a partner on or after January 9, 1995.

[T.D. 8642, 60 FR 66739, Dec. 26, 1995]

TRANSFERS OF INTERESTS IN A  
PARTNERSHIP

**§ 1.741-1 Recognition and character of gain or loss on sale or exchange.**

(a) The sale or exchange of an interest in a partnership shall, except to the extent section 751(a) applies, be treated as the sale or exchange of a capital asset, resulting in capital gain or loss measured by the difference between the amount realized and the adjusted basis of the partnership interest, as determined under section 705. For treatment of selling partner's distributive share up to date of sale, see section 706(c)(2). Where the provisions of section 751 require the recognition of ordinary income or loss with respect to a portion of the amount realized from such sale or exchange, the amount realized shall be reduced by the amount attributable under section 751 to unrealized receivables and substantially appreciated inventory items, and the adjusted basis of the transferor partner's interest in the partnership shall be reduced by the portion of such basis attributable to such unrealized receivables and substantially appreciated inventory items. See section 751 and § 1.751-1.

(b) Section 741 shall apply whether the partnership interest is sold to one or more members of the partnership or to one or more persons who are not members of the partnership. Section 741 shall also apply even though the sale of the partnership interest results in a termination of the partnership under section 708(b). Thus, the provisions of section 741 shall be applicable (1) to the transferor partner in a 2-man partnership when he sells his interest to the other partner, and (2) to all the members of a partnership when they sell their interests to one or more persons outside the partnership.

(c) See section 351 for nonrecognition of gain or loss upon transfer of a partnership interest to a corporation controlled by the transferor.

(d) For rules relating to the treatment of liabilities on the sale or exchange of interests in a partnership see §§ 1.752-1 and 1.1001-2.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 7741, 45 FR 81745, Dec. 12, 1980]

**§ 1.742-1 Basis of transferee partner's interest.**

The basis to a transferee partner of an interest in a partnership shall be determined under the general basis rules for property provided by part II (section 1011 and following), subchapter O, chapter 1 of the Code. Thus, the basis of a purchased interest will be its cost. The basis of a partnership interest acquired from a decedent is the fair market value of the interest at the date of his death or at the alternate valuation date, increased by his estate's or other successor's share of partnership liabilities, if any, on that date, and reduced to the extent that such value is attributable to items constituting income in respect of a decedent (see section 753 and paragraph (c)(3)(v) of § 1.706-1 and paragraph (b) of § 1.753-1) under section 691. See section 1014(c). For basis of contributing partner's interest, see section 722. The basis so determined is then subject to the adjustments provided in section 705.

**§ 1.743-1 Optional adjustment to basis of partnership property.**

(a) *General rule.* The basis of partnership property shall not be adjusted as the result of a transfer of an interest in a partnership, either by sale or exchange or as a result of the death of a partner, unless the election provided by section 754 (relating to optional adjustment to basis of partnership property) is in effect with respect to the partnership. However, whether or not the election provided in section 754 is in effect, the basis of partnership property shall not be adjusted as the result of a contribution of property, including money, to the partnership.

(b) *Adjustment to basis of partnership property—(1) Determination of adjustment.* In the case of a transfer of an interest in a partnership, either by sale or exchange or as a result of the death of a partner, a partnership as to which

the election under section 754 is in effect shall:

(i) Increase the adjusted basis of partnership property by the excess of the transferee's basis for his partnership interest over his share of the adjusted basis to the partnership of all partnership property, or

(ii) Decrease the adjusted basis of partnership property by the excess of the transferee partner's share of the adjusted basis of all partnership property over his basis for his partnership interest.

The amount of the increase or decrease constitutes an adjustment affecting the basis of partnership property with respect to the transferee partner only. Thus, for purposes of depreciation, depletion, gain or loss, and distributions, the transferee partner will have a special basis for those partnership properties which are adjusted under section 743(b) and this paragraph. This special basis is his share of the common partnership basis (i.e., the adjusted basis of such properties to the partnership without regard to any special basis adjustments of any transferee) plus or minus his special basis adjustments. A partner's share of the adjusted basis of partnership property is equal to the sum of his interest as a partner in partnership capital and surplus, plus his share of partnership liabilities. Where an agreement with respect to contributed property is in effect under section 704(c)(2), such agreement shall be taken into account in determining a partner's share of the adjusted basis of partnership property. Generally, if a partner's interest in partnership capital and profits is one-third, his share of the adjusted basis of partnership property will be one-third of such basis. The provisions of this paragraph may be illustrated by the following examples:

**Example 1.** A is a member of partnership ABC in which the partners have equal interests in capital and profits. The partnership has made the election under section 754, relating to the optional adjustment to the basis of partnership property. A sells his interest to P for \$22,000. The balance sheet of the partnership at the date of sale shows the following:

ASSETS		
	Adjusted basis per books	Market value
Cash .....	\$5,000	\$5,000
Accounts receivable .....	10,000	10,000
Inventory .....	20,000	21,000
Depreciable assets .....	20,000	40,000
Total .....	55,000	76,000

  

LIABILITIES AND CAPITAL		
	Adjusted basis per books	Value
Liabilities .....	\$10,000	\$10,000
Capital:		
A .....	15,000	22,000
B .....	15,000	22,000
C .....	15,000	22,000
Total .....	55,000	76,000

The amount of the adjustment under section 743(b) is the difference between the basis of the transferee's interest in the partnership and his share of the adjusted basis of partnership property. Under section 742, the basis of P's interest is \$25,333 (the cash paid for A's interest, \$22,000, plus \$3,333, P's share of partnership liabilities). P's share of the adjusted basis of partnership property is \$18,333, i.e., \$15,000 plus \$3,333. The amount to be added to the basis of partnership property is, therefore, \$7,000, the difference between \$25,333 and \$18,333. This amount will be allocated to partnership properties in accordance with the rules set forth in section 755 and § 1.755-1.

**Example 2.** D is a member of partnership DEF in which the partners have equal interests in profits, but not in capital. The partnership has made the election under section 754. D dies and his interest passes to W, his widow. The balance sheet of the partnership at the date of D's death shows the following:

ASSETS		
	Adjusted basis per books	Market value
Cash .....	\$7,000	\$7,000
Accounts receivable .....	10,000	10,000
Inventory .....	20,000	24,000
Depreciable assets .....	20,000	40,000
Total .....	57,000	81,000

  

LIABILITIES AND CAPITAL		
	Adjusted basis per books	Value
Liabilities .....	\$10,000	\$10,000

## LIABILITIES AND CAPITAL—Continued

	Adjusted basis per books	Value
Capital:		
D .....	18,000	26,000
E .....	15,000	23,000
F .....	14,000	22,000
Total .....	57,000	81,000

The amount of the adjustment under section 743(b) is the difference between the basis of the transferee's interest in the partnership and her share of the adjusted basis of partnership property. Under section 742, the basis of W's interest is \$29,333 (the fair market value of D's interest at his death, \$26,000, plus \$3,333, his share of partnership liabilities). W's share of the adjusted basis of partnership property is \$21,333 (i.e., \$18,000 plus \$3,333, her share of partnership liabilities). The amount to be added to the basis of partnership property is, therefore, \$8,000, the difference between \$29,333 and \$21,333. This amount will be allocated to partnership properties in accordance with the rules set forth in section 755 and § 1.755-1.

Note that in examples 1 and 2 of this subparagraph the amount of the adjustment does not depend upon the adjusted basis to the transferor for his interest in partnership capital.

(2) *Determination of partner's share of adjusted basis of partnership property.* (i) Under the provisions of section 743(b), a partner's share of the adjusted basis of partnership property shall be determined by taking into account the effect of any partnership agreement with respect to contributed property as described in section 704(c)(2), or the effect of the contribution of undivided interests under section 704(c)(3). This rule may be illustrated by the following examples:

*Example 1.* A, B, and C form partnership ABC, to which A contributes land worth \$1,000 (property X) with an adjusted basis to him of \$400, and B and C each contributes \$1,000 cash. Each partner has \$1,000 credited to him on the books of the partnership as his capital contribution. The partners share in profits equally. During the partnership's first taxable year, property X appreciates in value to \$1,300. A sells his one-third interest in the partnership to D for \$1,100, when the election under section 754 is in effect. No agreement under section 704(c)(2) is in effect. The adjusted basis of the partnership property is increased with respect to D by the excess of his basis for his partnership interest, \$1,100, over his share of the adjusted basis of

partnership property, \$800 (1/3 of \$2,400, the total adjusted basis of partnership property). The amount of the adjustment, therefore, is \$300 (\$1,100 minus \$800), which is an increase in the basis of partnership property with respect to D only. This special basis adjustment will be allocated to property X. (See section 755 and § 1.755-1.) If property X is sold for \$1,600, the gain to the partnership is \$1,200 (\$1,600 received, less the adjusted common partnership basis of \$400 for property X). Thus, each partner's distributive share of the gain on the sale is \$400. However, D's recognized gain is only \$100 (his \$400 distributive share of the gain, reduced by \$300, his special basis adjustment with respect to property X). If D purchased his interest from B or C, the partners who contributed cash, D's adjustment under section 743(b) would also be \$300, computed in exactly the same manner as in the case of a purchase from A.

*Example 2.* Assume that partnership ABC described in example 1 of this subdivision has an agreement under section 704(c)(2) with respect to property X, stating that upon the sale of that property any gain, to the extent attributable to the precontribution appreciation of \$600 (the difference between its value, \$1,000, and its basis, \$400, at the time of the contribution) is to be allocated entirely to A, who contributed property X. Upon the purchase of A's interest by D for \$1,100, the computation of D's special basis would differ from that indicated in example 1 of this subdivision as follows: Under the partnership agreement, A's share of the \$2,400 adjusted basis of partnership property is only \$400 (his basis for property X prior to its contribution to the partnership), and B's and C's share is \$1,000 each (the amount of the cash investment of each). The amount of the increase to D in the adjusted basis of partnership property under section 743(b)(1) is \$700 (the excess of \$1,100, D's cost basis for his interest, over \$400, A's share of the adjusted basis of partnership property to which D succeeds). This amount constitutes an adjustment to the basis of partnership property with respect to D only. If X is sold by the partnership for \$1,600, the gain is \$1,200 (\$1,600 received less the adjusted common partnership basis of \$400). Under the partnership agreement, \$600 of this gain, which is attributable to precontribution appreciation in value, is allocable to D, who is A's successor. The remaining \$600 gain is not subject to the agreement and is allocable to the partners equally, \$200 each. D's distributive share of the partnership gain is thus \$600 plus \$200, or \$800. However, D has a special basis adjustment of \$700 under section 743(b)(1), which reduces his gain from \$800 to \$100. B and C each has a gain of \$200, which is unaffected by the transfer of A's interest to D.

*Example 3.* Assume the same facts as in example 2 of this subdivision, except that D has purchased his interest from B instead of

from A. His special basis adjustment for partnership property in this case differs from that where he had purchased his interest from A, because of the effect of the agreement under section 704(c)(2). In this case, D is a successor to B, whose share of the adjusted basis of partnership property is \$1,000, instead of A, whose share is only \$400. As a result, the adjustment under section 743(b)(1) is the excess of D's cost basis for his interest, \$1,100, over his share of the adjusted basis of partnership property, \$1,000, or \$100. In this case, if property X is sold for \$1,600, the partnership gain is \$1,200 (\$1,600 less the adjusted partnership basis of \$400). Of this gain, \$600, representing precontribution appreciation, is allocable to A under the partnership agreement. The remaining \$600 is allocable in the amount of \$200 to each partner. Since D as a transferee has a special basis adjustment of \$100 under section 743(b)(1), his gain is reduced from \$200 to \$100.

(ii) If a partner receives a distribution of property with respect to which another partner has a special basis adjustment, the distributee shall not take into account the special basis adjustment of the other partner. However, the partner with the special basis adjustment will reallocate it under section 755 to remaining partnership property of a like kind or, if he receives a distribution of like property, to such distributed property. If a partner receives a distribution of property with respect to which he has a special basis adjustment, such basis adjustment will be taken into account when relevant under section 732. See paragraph (b) of § 1.732-2. If, at the time a partner receives property (whether or not he has a special basis adjustment with respect to such property), he relinquishes his interest in other property of a like kind with respect to which he has a special basis adjustment, the adjusted basis to the partnership of the distributed property shall include his special basis adjustment for the property in which he relinquished his interest. For the purposes of the preceding sentence, a partner will be considered as having relinquished his interest in any re-

maining partnership properties when his interest has been completely liquidated; however, when a partner receives a distribution not in liquidation, he will be considered as relinquishing his interest only in property distributed to other partners. For the purposes of this subdivision, like property means property of the same class, that is, stock in trade, property used in the trade or business, capital assets, etc. For certain adjustments to the basis of remaining partnership property after a distribution to a transferee partner, see paragraph (b) of § 1.734-2. The provisions of this subdivision may be illustrated by the following examples:

*Example 1.* C is a transferee partner in partnership BC. The partnership owns, among other assets, X, a depreciable asset with a common basis to the partnership of \$1,000 and a special basis adjustment to C of \$200, and Y, another depreciable asset with a common basis of \$800 and a special basis adjustment to C of \$300. B and C agree that B will receive a distribution of property Y, and C will receive a distribution of property X, with all other property to remain in the partnership. With respect to B, the partnership basis of property Y is \$800, the common partnership basis. Y will, therefore, have a basis of \$800 in B's hands under section 732(a) which provides for the use of a carryover basis in the case of current distributions. With respect to C, however, the partnership basis of property X is \$1,500, the common partnership basis of \$1,000, plus C's special basis adjustment of \$200 for property X, plus C's additional special basis adjustment of \$300 for property Y, in which he has relinquished his interest.

*Example 2.* (a) Partner D acquired his one-third interest in partnership BCD for \$14,000 from a previous partner when an election under section 754 was in effect. Therefore, under section 743(b), D has a special basis adjustment for certain partnership property. Assume that at the time of the distribution in paragraph (b) of this example, the partnership assets consist of cash and rental property and that such assets and D's special basis adjustments under section 743(b) are as follows:

Item	Fair market value	Common partnership basis	D's share	D's special basis adjustment	Partnership basis to D
Cash .....	\$12,000	\$12,000	\$4,000	.....	\$4,000
House:					
U .....	9,000	1,200	400	.....	400
V .....	6,000	4,500	1,500	.....	1,500

Item	Fair market value	Common partnership basis	D's share	D's special basis adjustment	Partnership basis to D
W .....	8,000	1,500	500	.....	500
X .....	9,000	4,800	1,600	\$2,000	3,600
Y .....	9,000	6,000	2,000	.....	2,000
Z .....	7,000	3,000	1,000	1,000	2,000
Total .....	60,000	33,000	11,000	3,000	14,000

(b) Assume further that D receives \$4,000 in cash and houses Y and Z in complete liquidation of his interest in partnership BCD. In determining the basis to D of houses Y and Z under section 732 (b) and (c), D must allocate \$10,000 basis (\$14,000 basis for his interest, less \$4,000 cash received) to houses Y and Z in proportion to their adjusted basis to the partnership. For purposes of section 732(c), the adjusted basis of house Y is \$7,200. (\$6,000 common partnership basis, plus \$1,200, allocated share of D's special basis adjustment of \$2,000 for house X, in which D relinquished his interest). The adjusted basis of house Z is \$4,800 (\$3,000 common partnership basis, plus \$1,000, D's special basis for house Z, plus \$800, allocated share of D's special basis of \$2,000 for house X, in which D relinquished his interest). Under the rule of this subdivision, 6,000/10,000 of the \$2,000 special basis adjustment for X is allocated to Y and 4,000/10,000 of such amount to Z. Therefore, \$6,000 basis (7,200/12,000 of \$10,000) is allocated to house Y and \$4,000 basis (4,800/12,000 of \$10,000) to house Z.

(c) Since houses Y and Z had \$12,000 basis to the partnership, as computed in paragraph (b) of this example, and only \$10,000 basis to D, as determined under section 732, the partnership, under section 734(b)(1)(B), must increase the basis of remaining partnership property (houses U, V, W, and X) by \$2,000 (excess of \$12,000 over \$10,000). For allocation of this amount, see section 755 and § 1.755-1.

(iii) Where an adjustment is made under section 743(b) to the basis of partnership property subject to depletion, any depletion allowable shall be determined separately for each partner, including the transferee partner, based on his interest in such property. See paragraph (a)(8) of § 1.702-1. This rule may be illustrated by the following example:

*Example.* A, B, and C each contributes \$5,000 cash to form partnership ABC, which purchases oil property for \$15,000. C subsequently sells his partnership interest to D for \$100,000 when the election under section 754 is in effect. D has a special basis adjustment for the oil property of \$95,000 (the difference between D's basis, \$100,000, and his

share of the basis of partnership property, \$5,000). Assume that the depletion allowance computed under the percentage method would be \$21,000 for the taxable year so that each partner would be entitled to \$7,000 as his share of the deduction for depletion. However, under the cost depletion method, at an assumed rate of 10 percent, the allowance with respect to D's one-third interest which has a basis to him of \$100,000 (\$5,000, plus his special basis adjustment of \$95,000) is \$10,000, although the cost depletion allowance with respect to the one-third interest of A and B in the oil property, each of which has a basis of \$5,000, is only \$500. For partners A and B, the percentage depletion is greater than cost depletion and each will deduct \$7,000 based on the percentage depletion method. However, as to D, the transferee partner, the cost depletion method results in a greater allowance and D will, therefore, deduct \$10,000 based on cost depletion. See section 613(a).

(iv) Where there has been more than one transfer of partnership interests, the last transferee's special basis adjustment, if any, under section 743(b) shall be determined by reference to the partnership common basis for its property without regard to any prior transferee's special basis adjustment. For example, A, B, and C form a partnership. A and B each contributes \$1,000 cash and C contributes land with a basis and value of \$1,000. When the land has appreciated in value to \$1,300, A sells his interest to D for \$1,100 (1/3 of \$3,300, the value of the partnership property). The election under section 754 is in effect; therefore, D has a special basis adjustment of \$100 with respect to the land under section 743(b). After the land has further appreciated in value to \$1,600, D sells his interest to E for \$1,200 (1/3 of \$3,600, the value of the partnership property). Under section 743(b), E has a special basis adjustment of \$200. This amount is determined without regard to any special

basis adjustment that D may have had in the partnership assets.

(3) *Returns.* A transferee partner who has a special basis adjustment under section 743(b) shall attach a statement to his income tax return for the first taxable year in which the basis of any partnership property subject to the adjustment is pertinent in determining his income tax, showing the computation of the adjustment and the partnership properties to which the adjustment has been allocated.

(c) *Allocation of basis.* For the allocation of basis among partnership properties where section 743 (b) applies, see section 755 and § 1.755-1.

(d) *Section 708(b)(1)(B) terminations.* A partner with a special basis adjustment in property held by a partnership that terminates under section 708(b)(1)(B) will continue to have the same special basis adjustment with respect to property deemed contributed by the terminated partnership to the new partnership under § 1.708-1(b)(1)(iv), regardless of whether the new partnership makes a section 754 election. This paragraph (d) applies to terminations of partnerships under section 708(b)(1)(B) occurring on or after May 9, 1997; however, this paragraph (d) may be applied to terminations occurring on or after May 9, 1996, provided that the partnership and its partners apply this paragraph (d) to the termination in a consistent manner.

[T.D. 6500, 25 FR 11814, Nov. 26, 1960; 25 FR 14021, Dec. 31, 1960, as amended by T.D. 8717, 62 FR 25501, May 9, 1997]

PROVISIONS COMMON TO PART II,  
SUBCHAPTER K, CHAPTER 1 OF THE CODE

**§ 1.751-1 Unrealized receivables and inventory items.**

(a) *Sale or exchange of interest in a partnership—(1) Character of amount realized.* To the extent that money or property received by a partner in exchange for all or part of his partnership interest is attributable to his share of the value of partnership unrealized receivables or substantially appreciated inventory items, the money or fair market value of the property received shall be considered as an amount realized from the sale or exchange of property other than a capital asset. The re-

mainder of the total amount realized on the sale or exchange of the partnership interest is realized from the sale or exchange of a capital asset under section 741. For definition of “unrealized receivables” and “inventory items which have appreciated substantially in value”, see section 751 (c) and (d). Unrealized receivables and substantially appreciated inventory items are hereafter in this section referred to as “section 751 property”. See paragraph (e) of this section.

(2) *Determination of gain or loss.* The income or loss realized by a partner upon the sale or exchange of his interest in section 751 property is the difference between (i) the portion of the total amount realized for the partnership interest allocated to section 751 property, and (ii) the portion of the selling partner's basis for his entire interest allocated to such property. Generally, the portion of the total amount realized which the seller and the purchaser allocate to section 751 property in an arm's length agreement will be regarded as correct. The portion of the partner's adjusted basis for his partnership interest to be allocated to section 751 property shall be an amount equal to the basis such property would have had under section 732 (including subsection (d) thereof) if the selling partner had received his share of such properties in a current distribution made immediately before the sale. See §§ 1.732-1 and 1.732-2. Such basis shall reflect the rules of section 704(c)(3), if applicable, or any agreement under section 704(c)(2). Any gain or loss recognized which is attributable to section 751 property will be ordinary gain or loss. The difference between the remainder, if any, of the partner's adjusted basis for his partnership interest and the balance, if any, of the amount realized is the transferor's capital gain or loss on the sale of his partnership interest.

(3) *Statement required.* A transferor partner selling or exchanging any part of his interest in a partnership which has any section 751 property at the time of sale or exchange shall submit with his income tax return for the taxable year in which the sale or exchange occurs a statement setting forth separately the following information: